tial additional information provided by cable operators and programmers, which demonstrate that cable operators do not discriminate in favor of affiliated programmers when making carriage decisions. See supra at Section I-C. Moreover, these commenters offer no evidence to dispute the fact that "[t]he incentive to increase subscribership -- from which the cable operator exclusively derives the additional revenues -- outweighs any incentive to favor carriage of less popular programming from which the cable operator must share revenues with other investors." Liberty Media Comments at 16-17; see also Joint Comments of Cablevision Industries Corporation and Comcast Corporation ("Joint Comments") at 38 n.39 ("it is highly unlikely that an MSO will sacrifice its own subscriber penetration for the sake of a five-percent ownership interest in a programming service by favoring affiliated -- but unpopular -- programming over non-affiliated programmers").

Likewise, INTV and the telco commenters offer no evidence of the likely effect of their attribution proposals on the development of new programming services. In contrast, nearly every cable operator and programmer addressing this issue warns that an overly restrictive attribution standard would have a destructive effect on programming. See Time Warner Comments at 38 ("the 5% attribution standard...carries real potential to discourage needed investment in new program services"); Family Comments at 7 ("it would gravely imperil necessary cable industry investment in cable programmers if the channel limitations were...based on the five-percent level used for attribution of ownership in the broadcast industry, or even at the ten-percent level currently being considered for that industry"). The Motion Picture Association of America ("MPAA") also contends that "a relatively large attribution figure," in excess of the broadcast standard, is justified "by marketplace circumstances" because it "is common in cable programming for a large number of cable operators each to take a small stake in a programmer." MPAA Comments at 7 n.8.

The Commission's selection of a 5 percent attribution standard for purposes of the program access provisions of Section 19 further necessitates the adoption of a higher attribution standard for the channel occupancy limits under Section 11. Comments of the National Cable Television Association, Inc. ("NCTA") at 29 ("application of a low attribution standard will absolutely destroy the incentive for cable operator investment in program networks, particularly when the programmer's ownership of a small equity interest in the cable operator. Unless the programmer holds a controlling equity interest, or otherwise assumes management responsibility for particular cable systems, it simply does not have the ability to override the cable operator's incentive to carry that programming which is most likely to increase subscribership. Thus, absent a controlling interest or management responsibility, a programmer would not have the ability to force a cable operator to discriminate in favor of its programming services.

B. Any Channel Occupancy Limits Should Be Based On A Substantial Percentage Of All Activated Channels And Limited To Services Affiliated With That System Operator.

The ownership attribution levels proposed by INTV and the telco commenters become even more unreasonable when viewed in the context of the substantive channel occupancy restrictions proposed by INTV and others. The unifying theme of these proposals is to minimize the number of channels on which a cable operator may carry affiliated programming, without regard to their effect on the development of new and better programming services for consumers. Such unprincipled proposals are plainly contrary to the record in this proceeding.

For example, INTV suggests a variety of restrictions which would virtually eliminate investment by cable operators in new programming services. First, INTV would prohibit existing cable operators from devoting "more than 20 percent of existing channel capacity to program services in which they have an equity interest." INTV Comments at 12.[5] In calculating the percentage limit, INTV would have the Commission subtract from the denominator "the number of channels actually used by a cable operator to fulfill its must-carry, leased access and governmental PEG channels"[6] and include in the numerator any affiliated pay, pay-per-view, and multiplexed channels. Id. at 11 and n.13 (emphasis in original). Thus, on a 36-channel system with maximum must-carry obligations and 3 PEG channels, a cable operator would be permitted to carry programming in which it holds any equity interest on only 3 channels.

Apparently unsatisfied that its percentage proposal would have a sufficiently draconian effect, particularly in the event that the cable system dramatically expanded its channel capacity,[7] INTV also proposes an absolute "upper

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[5] MPAA also suggests a "simple and straightforward channel occupancy limit" based on 20 percent of a cable system's activated channels. MPAA Comments at 7-8.

[6] The National Association of Telecommunications Officers and Advisors and National League of Cities ("NATOA/NLC") similarly contend that must-carry and PEG channels be subtracted from the denominator in calculating channel occupancy limits. NATOA/NLC Comments at 21.

[7] In contrast, most commenters suggested that the channel occupancy limits be eliminated once a system reaches a capacity of 54 or more channels. Comments of Viacom International, Inc. ("Viacom") at 15; E! Entertainment Comments at 10; Joint Comments at 39; Time Warner Comments at 57; Discovery Comments at 17.

numerical limit on the number of program channels that could be owned by any one cable company." INTV Comments at 11. Finally, to ensure that cable operators would be unable to invest in any new program services, INTV suggests that the Commission establish the "upper numerical limit" by "freez-[ing] the number of cable program services currently owned by cable MSOs." Id.

The record clearly does not support the need for the restrictive channel occupancy limits advocated by INTV. At the outset, INTV asks the Commission to ensure "that a large portion, perhaps 80 percent, of an MSO's channel capacity be devoted to independent program sources" (INTV Comments at 10) -- when not one programmer has alleged that it has been denied carriage on any cable system because the operator chose to carry an affiliated programming service instead. Clearly, there is no justification for INTV's set aside, and INTV makes absolutely no effort to provide empirical or analytical support for its proposed percentage limit.

In addition, there is no basis for INTV's and NATOA/NLC's suggestions that must-carry, PEG and leased access channels be subtracted in calculating the applicable channel occupancy limit. These channels provide outlets for unaffiliated programmers and contribute to the diversity of viewpoints available to consumers. See TBS Comments at 17; Viacom Comments at 14; NCTA Comments at 30; MPAA Comments at 8. Moreover, the beneficiaries of the must-carry provisions were the primary, if not exclusive, proponents of channel occupancy limits before Congress. See Liberty Media Comments at 19-21. Further, the Commission's rate regulations include additional provisions designed to increase the viability of commercial leased access channels as yet another outlet for unaffiliated programmers. See Report and Order and Further Notice of Proposed Rulemaking, MM Docket 92-266, FCC 93-177 (rel. May 3, 1993), at ¶¶485-559.

INTV's proposed 20 percent limit, combined with its exclusion of must-carry, leased access and PEG channels, clearly has the potential to disrupt existing service to viewers. As set forth above, INTV's proposal could leave the operator of a 36-channel system with as few as 3 channels for affiliating programming services. Liberty Media has ownership interests in nine "basic" cable programming services and provides transmission service for another. See Crandall Analysis, Exhibit A, at Table I. Several MSOs reported having interests in 10 or more services. See Time Warner Comments at 51 (Time Warner has equity interests exceeding 5 percent in 15 programming services); Viacom Comments at 1 (Viacom has direct or indirect interests in approximately 10 program services). Pursuant to INTV's proposal, subscribers in one franchise area may be denied access to popular programming enjoyed by subscribers in an adjoining franchise area simply because of the identity and program investments of their cable operator. See TBS Comments at 18-19; Viacom Comments at 5. The record simply does not justify the service disruptions likely to result from the overly restrictive channel occupancy limits suggested by INTV.

Finally, no commenter suggested that the channel occupancy limits should apply to program services affiliated with any cable operator other than the operator of the system in question. See Notice at ¶49. A cable operator clearly "has no incentive to discriminate in favor of a program service affiliated with another cable operator." Viacom Comments at 7; see also TBS Comments at 16; Joint Comments at 35-36; Time Warner Comments at 46. Consequently, the record confirms the Commission's tentative conclusion that the most reasonable approach "is to apply [channel occupancy] limits only to video programmers affiliated with the particular cable operator" of the system in question. Notice at ¶50.

C. The Commission Should Exempt Local And Regional Services And Other Services For Which There Is Demonstrated Subscriber Demand.

Channel occupancy limits should neither undermine the "substantial government interest" in local origination and diversity of programming nor override the viewing preferences of consumers. Consequently, the Commission should exempt from channel occupancy limits local and regional programming services because such programming promotes diversity and provides coverage of local news, public affairs, sports and other local and regional issues. Likewise, the Commission should exempt program services for which there is a demonstrated demand on the part of subscribers.

1. <u>Local And Regional Services.</u>

Among the policy objectives of the 1992 Cable Act is the promotion of: (a) a "diversity of views and information" available to the public; and (b) the "substantial government interest" in the local origination of programming. 1992 Cable Act, §§2(a)(10) and 2(b)(1). Local and regional programming services, including regional sports services, clearly contribute to both of these objectives. The Commission and the courts have recognized that program origination by cable operators serves the public interest "by increasing the number of outlets for community self-expression and augmenting the public's choice of programs and types of services" and by providing television coverage of "local events [such] as community concerts, civic meetings, local sports events and other programs of local consumer and social interest." <u>United States v. Midwest Video Corp.</u>, 406 U.S. 649, 667-69 (1972).

The comments submitted in this proceeding confirm the significant public interest benefits resulting from local and regional programming developed by or in conjunction with cable operators. <u>See supra</u> at Section I-B. However, local and regional programming services, particularly news and sports services, cost more than many other programming formats. For example, Continental estimates that the start-up costs and operating losses over the first two years of its New England Cable News service will exceed $14 million. Continental Comments at 12. Likewise, regional sports services involve high costs for rights fees and the equipment and crews needed to televise sports events. Moreover, because "sports events have substantial entertainment value only at the time of their occurrence," these costs normally "cannot be spread over multiple showings of that programming." See ARC Comments at 5-6. Consequently, application of channel occupancy limits to local and regional programming services may cause the demise of those services. See Viacom Comments at 12 (because local and regional services "generally provide little or no revenue, and certainly less revenue than national program services, including them in the channel occupancy limitation would serve only to discourage cable operators from providing locally produced programming to their subscribers."). To avoid that result, which "runs directly counter to the Act's stated objective," the Commission should exempt local and regional services from the channel occupancy limit. Id.

2. Services Demanded By Subscribers.

strated viewer demand. Carriage of such programming services by an affiliated cable operator simply is not the type of "favoritism" against which Section 11 was designed to protect.

Commenters have suggested a variety of alternatives by which the Commission could "determine whether the carriage of a commonly-owned program service is reasonably reflective of consumer interest or an attempt by the cable operator to impermissibly disadvantage a non-affiliated entity." Viacom Comments at 5. The most logical alternative is to apply the channel occupancy limits on a complaint basis only, because it would make no sense "to preclude a system from carrying a new cable network in which it had made an investment if there were no other [unaffiliated] cable network complaining that it wanted access." Family Comments at 5; <u>see also</u> Time-Warner Comments at 59; Joint Comments at 42.[8]

Another alternative would exempt certain program services from the channel occupancy limits based on an objective measure of the popularity of those services among consumers. For example, carriage of a particular service by a

[8] Certain commenters seek to impose upon cable operators a variety of reporting and certification requirements in connection with the channel occupancy limits. <u>See</u> NATOA/NLC Comments at 22 (quarterly submission of programming interests to FCC and regular certification of compliance to franchise authorities). However, absent a complaint from an unaffil-

given percentage of unaffiliated cable systems would indicate that the service is "highly valued in the marketplace" and should be exempt from channel occupancy limits. See Viacom Comments at 6 (services carried "by cable systems not under common ownership with the programmer that serve more than 50% of cable subscribers nationwide," excluding subscribers to systems affiliated with the programmer, should be exempt); Time Warner Comments at 54 ("the channel occupancy limit should not be applied to any vertically integrated programming service that...is available to 40% or more of the subscribers of non-affiliated operators"); Discovery Comments at 18 ("if a programming service were carried by 50% or more of the cable operators who had no ownership interest in it, a cable system with an interest in a programming service should be presumed to be carrying it on the merits, and it should be exempt").

Finally, several commenters have suggested that the channel occupancy limits should not apply to new services in which a cable operator has an attributable interest. See Viacom Comments at 8-9; Discovery Comments at 18 (proposing a five-year exemption for new services). Such an exemption would preserve the incentive for cable operators to invest in new programming services and to phase out existing services which have not proven popular with viewers. At a minimum, the Commission should permit cable operators already at their limit to add new affiliated services upon a showing that subscribers prefer those services over existing services or other new services. See Liberty Media Comments at 29 ("the Commission should establish a waiver procedure by which a cable operator can demonstrate that an affiliated programming service is being added in response to viewer demand regardless of the channel occupancy limits.").

III. Subscriber Limits Should Be Based On A Percentage Of Homes Passed Nationwide.

Section 11 also requires the Commission to prescribe rules "establishing reasonable limits on the number of cable subscribers a person is authorized to reach through cable systems owned by such person, or in which such person has an attributable interest." 1992 Cable Act, §11(c). The Commission states that this provision "is intended to address Congress' concern regarding increasing horizontal concentration in the cable industry," which may have "the potential to create barriers to entry for new programmers and to reduce... the number of media voices available to consumers." Notice at ¶¶31-32. The record clearly indicates that only national subscriber limits are appropriate and that those limits should be no lower than 30 to 40 percent of total homes passed.

A. Any Horizontal Ownership Limits Should Apply Nationwide.

Although the Commission questions "whether regional or national subscriber limits, or both, are necessary or appropriate to implement the objectives of the 1992 Cable Act" (Notice at ¶35), the record demonstrates that regional subscriber limits are unnecessary and would undermine several of the policy objectives of the 1992 Cable Act. While cable operators and programmers have identified numerous benefits stemming from regional consolidation (see supra at Section I-B), the only party advocating regional ownership limits has a vested interest in precluding competition from the local and regional programming services made possible by regional consolidation.

With the exception of INTV, commenters addressing this issue uniformly contend that there is no basis or need for regional subscriber limits. See, e.g., Cablevision Comments at 1 ("[n]either the Act, its underlying legislative history, nor public policy support imposition of regional subscriber limits"); Continental Comments at 3-4 ("regional concentration limits could seriously impede the growth and development of the cable industry, and eliminate many...public benefits"); Liberty Media Comments at 22 ("regional concentraissue of regional concentration"); TCI Comments at 27 ("the statute provides neither the authority nor a public policy rationale for regional limitations").

The sole proponent of regional subscriber limits is INTV, which has a vested financial interest in precluding the development and growth of local and regional news and sports services. INTV contends that "the FCC should prohibit a single cable operator from reaching more than 50 percent of the homes passed in a local market (ADI)" because it "believes" that regional cable consolidation can "distort competition in the local marketplace," specifically "local advertising markets." INTV Comments at 7-8.

However, the "distortion" about which INTV complains is nothing more than the introduction of a new competitor into local and regional advertising markets. Regional consolidation facilitates the introduction of new local and regional programming services and the sale of local advertising time. See supra at Section I-B; Continental Comments at 15-16. The Commission should recognize INTV's proposal to establish regional subscriber limits for the protectionist measure that it is and reject it accordingly.

B. Any National Subscriber Limit Should Not Be Lower Than 30 To 40 Percent Of Homes Passed.

The 1992 Cable Act and its legislative history indicate that the national subscriber limits required by

Section 11 should be: (a) low enough to ensure that large multiple system owners neither "create barriers to entry for new programmers" nor achieve "sufficient market power to extract unreasonable concessions from program suppliers and to unfairly restrain competition" (Notice at ¶¶32-33); and (b) high enough to avoid the implication "that any existing company must be divested." Cable Television Consumer Protection Act of 1991, S. Rep. No. 92, 102d Cong., 1st Sess. 34 (1991) ("Senate Report"). The record demonstrates that national limits in the range of 30 to 40 percent of homes passed would achieve both of these objectives.

For example, in arguing that "the FCC should limit all existing MSOs to a maximum 10 percent national audience reach limit," INTV simply dismisses the Senate Report by claiming that "there is nothing in the Report prohibiting the FCC from ordering divestiture." INTV Comments at 6. Other than this unusual interpretation of legislative history, INTV offers no principled basis for the unreasonably low standard which it advocates. The Commission found as recently as its 1990 Cable Report that the largest single MSO served "22.16 percent of all cable subscribers," but concluded that no single MSO had "the unilateral ability to preclude the successful launch of new programming services." Report to Congress, 5 FCC Rcd. at 4973, 5005. Thus, there is no basis for INTV's claim that a 10 percent national subscriber limit is necessary to respond to "fundamental concerns about...

access by independent cable programmers and the potential for discrimination." INTV Comments at 6.

Other commenters suggested somewhat higher national subscriber levels, but again offered no reasonable justification for their proposals. For example, NATOA/NLC simply states without explanation that the National League of Cities "has adopted a policy that no single cable company and its affiliates should be permitted to serve more than 25 percent of the nation's cable subscribers" and suggests that the Commission adopt a similar policy. NATOA/NLC Comments at 19. Likewise, MPAA suggests that a limit of "25 percent of homes passed would be reasonable," primarily because it "caps the largest cable MSO at its current level of concentration." MPAA Comments at 5.[9]

The only "analysis" purportedly supporting a national subscriber limit of 25 percent or lower is provided by David Waterman ("Waterman"). Waterman contends that his "economic analysis of the cable market and the broadcasting analogy...strongly suggest that an MSO having less than the Commission's suggested 25%-35% national share limit may exert excessive market power over networks -- particularly new entrants -- in the current market environment." Waterman

[9] However, MPAA "reserve[s] the right to seek a lower cap" if the regulations adopted by the Commission in the program access/anti-discrimination and leased access proceedings are not to its liking. MPAA Comments at 5-6. MPAA makes no effort to reconcile any such "lower cap" with the Senate Report.

Comments at 4. However, Waterman also states that "relevant data" regarding "the extent of the competitive advantage of audience reach in cable television...are very incomplete" and that "empirical support" for his analysis "remains limited at this point." Id.; "Multiple Cable Television System Operators and Monopsony Power" at 5. Moreover, his analysis does not consider "other important aspects of the question" of horizontal concentration. Waterman Comments at 4. Finally, Waterman concedes that "there are many examples of cable networks which are profitable with well-below full access to [all] cable subscribers"[10] and that "some networks are likely to have 'countervailing' market power with cable operators." Id. at 3-4.[11]

In contrast, traditional antitrust analysis and the realities of the cable program marketplace clearly support a higher national subscriber limit. Under relevant antitrust

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[10] Waterman attempts to rationalize the success of these networks by claiming that they "spend substantially less on programming, and tend to have relatively small audiences." Waterman comments at 3. The success of regional networks,

analysis, "it is well recognized that a single firm ordinarily cannot exercise monopoly power if it controls less than 50% of the relevant market." Time Warner Comments at 22; see also TCI Comments at 19-22; NCTA Comments at 17. In addition to economic and antitrust theory, empirical data from the program marketplace confirm that new services can be launched and sustained with penetration levels at or below 50 percent of all cable homes. See Time Warner Comments at 27 (citing numerous examples of existing program services founded at least five years ago, but having penetration rates well below 50 percent); TCI Comments at 25 (listing fifteen existing services with penetration levels under 51 percent of total cable subscribership). Moreover, many of today's most popular services entered the market with only a small fraction of total cable homes and grew slowly over a period of years. See Time Warner Comments at 27-28 (Family Channel "had achieved less than 10% penetration of all homes by its second year of operation" and took six years to approach 60% penetration; Nickelodeon "achieved only 15.1% penetration in its second year of operation...was still well below 40% in its fifth gramming service or permit that MSO to extract unreasonable concessions from unaffiliated programmers.

IV. Additional Restrictions On Cable Involvement In The Creation Or Production Of Video Programming Are Unnecessary And Unwarranted.

Certain broadcasters and alternative distributors seek a variety of additional structural regulations limiting or prohibiting cable involvement in the creation or production of video programming. These commenters offer nothing to justify their unreasonable proposals other than their unsupported speculation that such regulations "would not inhibit the development of new programming" because "[i]ndependent program companies are ready, willing and able" to develop new programming services. Liberty Cable Comments at 7; INTV Comments at 15. However, the record, including the comments of every programmer in this proceeding, clearly indicates that broad prohibitions or limitations on cable involvement in programming will adversely affect programmers and viewers alike.

Alternative distributors essentially seek to revise the attribution standard adopted in the Program Access Report by prohibiting any involvement, financial or otherwise, by cable operators in programming unless the programming is made available to them on an equal basis. For example, Liberty Cable claims that the Commission should absolutely prohibit "cable operators from any involvement, directly or indirectly, in the production of programming unless the cable operator makes programming available" to other multichannel video programming distributors "on the same terms and conditions as the programming is available to the cable operator." Liberty Cable Comments at 6-7. Likewise, NPCA argues that "the Commission should not hesitate to impose" additional structural restrictions on cable operators because "channel occupancy limits fail to address the problem which non-affiliated private and wireless operators have in obtaining non-discriminatory service from affiliated programmers." NPCA Comments at 14, 16-17.

Although they acknowledge that Section 19 and related Commission rules address directly the issue of program access by alternative distributors, NPCA and Liberty Cable seek additional structural restrictions just in case "any literal and practical ambiguities" under Section 19 might afford "private cable operators only limited and contingent relief from the problems of vertical integration." NPCA Comments at 18; see also Liberty Cable Comments at 6-7 (structural prohibitions on cable involvement in programming "would fill any gap argued to exist" under Section 19). However, the appropriate means to deal with any perceived "ambiguity" or "gap" in the Commission's rules regarding Section 19 is to petition for reconsideration or clarification of those rules, not to ban or to restrict cable involvement in the creation of new programming which clearly would adversely affect programmers and viewers.

Finally, INTV argues that the Commission "should limit the participation and production of programming by the largest cable MSOs" by prohibiting them "from owning an equity interest in any new cable programming services." INTV Comments at 14. INTV claims that this restriction is necessary because "[c]able is in a position to dominate the program production and acquisition market." Id. at 13. Aside from ignoring the fact that cable involvement in programming has increased output and diversity -- a fact confirmed by every programmer filing comments in this proceeding -- INTV is of the 1992 Cable Act and the Commission's implementing regulations.

Conclusion

Cable consolidation and investment in programming have resulted in significant and tangible benefits to programmers and viewers alike. Overly restrictive channel occupancy and subscriber limits will sacrifice efficiencies and deter investment in new programming services with no corresponding benefit to programmers or viewers. Additional structural limitations are unwarranted in any event.

Respectfully submitted,

May 12, 1993

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Exhibit A

Vertical Integration And Cable Operator Carriage Decisions

by

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The purpose of this paper is to examine what effect, if any, the vertical integration[2] of Liberty Media has on the carriage decisions of cable operators in which Liberty Media has an ownership interest. In previous research, I have examined whether the vertical integration of cable television operators with programming services raises competitive or diversity concerns. *See* R.W. Crandall, *Economic Analysis Of Market Structure in the Cable Television Business* (February 1990) (submitted in MM Docket No. 89-600 on March 1, 1990 with the Comments Of Tele-Communications, Inc. In Response To Notice Of Inquiry) (hereinafter *Economic Analysis Of Market Structure*). Further, I reported the results of an empirical study of the "basic" cable carriage decisions of cable systems in which Tele-Communications, Inc. ("TCI") had an ownership interest. *See* R.W. Crandall, *Vertical Integration And q Ratios In The Cable Industry* (March 1990) (submitted in MM Docket No. 89-600 on April 2, 1990 with the Reply Comments Of Tele-Communications,

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1 Senior Fellow, The Brookings Institution, Washington, D.C. This paper was commissioned by Liberty Media Corporation ("Liberty Media"). The views expressed are the author's own, and do not necessarily reflect the views of The Brookings Institution or of Liberty Media.

2 As used here, vertical integration refers to any ownership interest in a cable network, even if the interest is partial. It is more usual to define vertical integration as outright ownership or control of a supplying entity.

Inc. In Response To Notice Of Inquiry) (hereinafter *Vertical Integration*).

In my prior analyses of vertical integration in cable television, I identified two potential competitive concerns: (1) MSOs might refuse to provide the programming services in which they have an interest to competing distribution outlets such as SMATV operators or MMDS broadcasters; and (2) MSOs with programming service interests might seek to discriminate in their carriage decisions against competing programming services. Because the Commission has adopted in a separate proceeding comprehensive regulations addressing the availability of vertically integrated cable programming services to other distribution media and the terms and conditions thereof, I will not address the first potential concern in this analysis.[3]

At the outset, it is important to recognize that cable-operator investments in programming services have unquestionably benefitted cable television viewers. The Commission itself has recognized these benefits. In its 1990 analysis of the cable television industry, the Commission concluded that "[t]his vertical integration has increased both the quality and quantity of programming services available to the viewing public."[4] Indeed, the Commission reviewed a number of specific examples in which vertical integration by MSOs had "contributed to program diversity by providing

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[3] *See First Report And Order In Development Of Competition And Diversity In Video Programming Distribution And Carriage*, MM Docket No. 92-265 (rel. April 30, 1993).

[4] *Competition, Rate Deregulation And The Commission's Policies Relating To The Provision Of Cable Television Service*, 5 FCC Rcd. 4962, 5007 (1990) (hereinafter *Report to Congress*).